

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;  
Sudeen G. Kelly, Marc Spitzer,  
Philip D. Moeller, and Jon Wellinghoff.

Colonial Pipeline Company

Docket No. OR06-8-001

ORDER DENYING REHEARING

(Issued May 23, 2007)

1. On August 21, 2006, Hunt Refining Company (Hunt) filed a request for rehearing of the Order on Petition for Declaratory Order issued July 20, 2006, in this proceeding (July 20, 2006 Order).<sup>1</sup> In that order, the Commission granted in part Colonial Pipeline Company's (Colonial) petition and approved certain rate methodologies applicable to Colonial's proposed pipeline expansion between Baton Rouge, Louisiana, and Atlanta, Georgia.
2. In its request for rehearing, Hunt argues that the Commission erred by (1) approving Colonial's proposal for a uniform rate component (URC) surcharge rather than requiring the surcharge to be based on the length of haul, and (2) approving Colonial's proposal rather than requiring Colonial to conform to the Commission's rate methodologies.<sup>2</sup>
3. As discussed below, the Commission denies rehearing of the July 20, 2006 Order.

**Background**

4. Colonial transports approximately 2.4 million barrels per day (bpd) of refined petroleum products over its 5,519-mile system that extends from Houston, Texas, to the New York harbor area. The Colonial system serves numerous refineries in the Gulf

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<sup>1</sup> 116 FERC ¶ 61,078 (2006).

<sup>2</sup> 18 C.F.R. § 342 (2007).

Coast region, as well as consumer markets throughout the Southeast and Mid-Atlantic states, including the Atlanta, Washington, Baltimore, Philadelphia, and New York markets.

5. In recent years, Colonial has experienced capacity constraints on its system that required Colonial to prorate capacity, especially during the summer driving and winter heating seasons. For example, Colonial stated that, during 2004, it prorated some movements on its mainline approximately 25 percent of the time. Colonial explained that its system is most constrained between Collins, Mississippi, and Atlanta, Georgia. While Colonial pointed out its efforts to increase capacity, such as adding pumping power, it maintained that it had exhausted all options for increasing capacity other than installing additional pipe.

6. In its petition for a declaratory order, Colonial stated that it proposed to expand its system from Baton Rouge to Atlanta by adding a 36-inch diameter pipeline with a nominal 800,000 bpd capacity. According to Colonial, most of the additional pipeline would be constructed within Colonial's existing right-of-way, and the expansion would increase its capacity by 30 percent. Colonial projected that it could place the expansion capacity in service by 2010 at a cost of approximately \$1 billion. Given the size of the investment and the risk involved, Colonial sought certain assurances from the Commission.

7. While Colonial did not seek approval of a specific rate that would allow it to recover the costs of the expansion, it asked the Commission to pre-approve several elements of the rate framework and to provide other assurances. First, Colonial asked that its existing grandfathered transportation rates not be subject to change as a result of the expansion. Second, Colonial asked the Commission to permit it to recover the expansion costs through the URC that it would add to its existing transportation rates. Third, Colonial asked the Commission to allow it to calculate the proposed URC under the Opinion No. 154-B methodology, except that Colonial would:

- a. Apply the URC equally to all barrels that originate at Gulf Coast origins and are delivered to destinations beyond Baton Rouge;
- b. Include only incremental construction and operation costs in the URC;

- c. Use a capital structure based on the weighted average of the debt-to-equity ratios of Colonial's parent companies;<sup>3</sup>
- d. Use an equity return (ROE) based on that capital structure, following an approach the Commission has applied in other oil pipeline cases (*i.e.*, a discounted cash flow methodology using data applicable to a proxy group of publicly traded oil pipeline companies), set at the upper end of the range of reasonable returns, as determined by the formula used to determine the cost of equity for oil pipelines; and
- e. Use an accelerated depreciation rate based, for cost-of-service purposes, on a 20-year life.

Colonial projected that, if it calculated the URC as proposed, the URC would total less than one-half cent per gallon, or approximately 15 cents per barrel (cpb).

8. Hunt protested Colonial's filing. While Hunt agreed that shippers need additional capacity on the Colonial system, it opposed the rate and other assurances that Colonial requested. Specifically, Hunt opposed application of the URC to all barrels flowing from Baton Rouge onward. In effect, claimed Hunt, the URC would result in a much larger percentage rate increase for shorter hauls than for longer hauls. Hunt argued that such a rate increase is permissible only if a pipeline can show that its current rates are too low to permit it to recover its costs. According to Hunt, even without the URC, the expansion would generate enough additional revenue under Colonial's current rates to compensate the pipeline for its investment. Hunt further objected to Colonial's proposal to use the composite corporate structure of its parent companies and the higher ROE that would result from doing so.

9. In the July 20, 2006 Order, the Commission determined that the proposed expansion would ensure greater reliability and reduce the congestion on Colonial's system. The Commission also found that it is appropriate to encourage the proposed project through certain rate treatments, or incentives, in order to ensure reliable deliveries of competitively priced product to consumers.<sup>4</sup> The Commission rejected the claim that it would be premature to address certain rate issues through the petition for a declaratory

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<sup>3</sup> Colonial is owned by subsidiaries of five energy companies: CITGO, ConocoPhillips, Chevron, Koch, and Shell.

<sup>4</sup> *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 43-44 (2006).

order, emphasizing that it was not ruling on a specific rate and that Colonial would be obligated to provide the usual types of cost and other support when it subsequently files to recover the costs of the expansion.<sup>5</sup>

10. In response to Colonial's request for assurance that its existing grandfathered rates would not be challenged on the basis of a "substantial change in circumstances," the Commission stated that it would allow Colonial to charge the grandfathered rates for shipments over the expansion line. The Commission explained that an oil pipeline may apply a grandfathered rate to volumes shipped over new facilities where there is no change in the service or in the types of product being transported. Specifically, the Commission held that the mere act of charging grandfathered rates to incremental volumes created by an expansion of Colonial's mainline system would not constitute a substantial change in circumstances or in the nature of the services that were the basis for the rate so as to trigger a review of the rates grandfathered under section 1803(b) of the Energy Policy Act of 1992 (EPAAct).<sup>6</sup> However, the Commission cautioned that Colonial's proposed approach might afford it an over-recovery in an amount that could call into question the grandfathered rates. Relying on Colonial's commitment that it will recognize both sources of revenue (the URC and the revenue that will result from the increased volumes that it can ship because of the expansion) when it designs the URC, the Commission ruled that Colonial may implement a URC to recover its expansion costs so long as, in calculating the URC, Colonial subtracts the revenues earned by applying the existing rate to the additional volumes transported over the expansion. The Commission also emphasized that the grandfathered rates would continue to remain subject to complaint under the "substantial change in circumstances" standard. Additionally, the Commission held that the URC designed to recover the net unrecovered expansion costs, whether collected for shipments on the existing or the expansion facilities, will not be grandfathered.<sup>7</sup>

11. The Commission further determined to permit Colonial to recover the costs of its expansion project through a combination of its grandfathered rates and a URC that would apply to all barrels originating at Gulf Coast origins and delivered to destinations beyond Baton Rouge, subject to the reservations previously stated. Responding to Hunt's contention that Colonial should not impose the URC on every barrel from Baton Rouge onward, the Commission emphasized that Colonial's system is most constrained between

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<sup>5</sup> *Id.* at P 45.

<sup>6</sup> *Id.* at P 50-51.

<sup>7</sup> *Id.* at P 52-53.

Collins, Mississippi, and Atlanta, and that relieving that constraint also will benefit the system beyond the bottleneck. The Commission cited Colonial's statement that, absent the expansion, the bottleneck would extend further upstream. Thus, the Commission concluded that the shippers that transport downstream from Baton Rouge would benefit most from the proposed expansion.<sup>8</sup> Moreover, the Commission rejected the argument that it should not permit Colonial to apply the URC in a uniform fashion, finding that maintaining existing rate differentials would avoid significant market repercussions. The Commission stated, however, that it would address the level of costs included in the surcharge when Colonial actually files the cost-of-service data to collect the rate.<sup>9</sup>

12. The Commission declined to determine any particular ROE in this proceeding, observing that Colonial must support its desired ROE when it submits its cost-of-service data. For the same reason, the Commission also declined to impute the capital structure of Colonial's corporate parents at this juncture or to establish a depreciation rate.<sup>10</sup> Finally, the Commission ordered Colonial to make a subsequent filing to disclose any changes to the facts on which the rulings in this proceeding are based.<sup>11</sup>

### **Request for Rehearing**

#### **A. URC**

13. Hunt contends that the Commission erred in approving Colonial's URC proposal rather than requiring Colonial to base the surcharge on the relative length of the hauls. According to Hunt, Colonial's existing rates reflect some mileage-based differentiation, but they effectively discriminate against short-haul shippers like Hunt.<sup>12</sup> For example, Hunt states that the existing Houston - Atlanta rate is 82.82 cpb for a haul of 800 miles, while the Moundville, Alabama - Atlanta rate is 51.28 cpb for a haul of 200 miles. Thus,

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<sup>8</sup> *Id.* at P 55.

<sup>9</sup> *Id.* at P 57-58.

<sup>10</sup> *Id.* at P 59-63.

<sup>11</sup> *Id.* at P 64.

<sup>12</sup> Hunt states that all its rate comparisons are based on rates in effect on June 16, 2006.

continues Hunt, it pays approximately 1.59 cents more per mile to ship a barrel of product from Moundville to Atlanta than a shipper pays to have a barrel of product transported from Houston to Atlanta.<sup>13</sup>

14. Hunt's discrimination claim based on length of haul has no merit. Hunt bases its claim on the current differential between movements from Houston to Atlanta (800 miles) and movements from Moundville, Alabama, to Atlanta (200 miles). According to Hunt, that differential is now 1.59 cpb, but Hunt projects that the differential will become 2.091 cpb if the URC is added.<sup>14</sup>

15. Relative differences are already reflected in Colonial's existing grandfathered rates. Hunt has not shown that these differences result in similarly situated shippers being charged different rates for like service. It is not necessary, therefore, to base the URC on the relative distances of the movements. While Hunt claims that it is not challenging the existing grandfathered rates, its argument that the existing rates discriminate against short-haul shippers and that the URC will exacerbate that discrimination effectively represents a challenge to the existing just and reasonable grandfathered rates. This Hunt can do only by filing a complaint demonstrating a substantial change in the economic circumstances of the pipeline or in the nature of the services in accordance with section 1803 of the EPCRA. Hunt has not done so, and thus Colonial's just and reasonable rates have not been shown to be otherwise. The Commission also determined in the July 20, 2006 Order that application of the URC in this case will not constitute a substantial change in circumstances sufficient to trigger a review of the justness and reasonableness of Colonial's grandfathered rates.<sup>15</sup>

16. The Commission further affirms its conclusion that application of the URC will not constitute undue discrimination. Colonial proposes to apply the surcharge uniformly to all volumes that originate at the Gulf Coast and are delivered to destinations beyond Baton Rouge. All shippers who transport such volumes will derive benefits from the expansion because it will alleviate the constraints that have caused the significant prorationing that all such shippers have experienced on Colonial's system. Additionally, Colonial has shown that applying the URC in a uniform fashion to maintain existing rate

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<sup>13</sup> See Hunt Refining Company August 21, 2006 Request for Rehearing at 3-4. Hunt's calculations are not stated correctly. For example,  $82.82 \text{ cpd} / 800 \text{ miles} = .1035$ .

<sup>14</sup> *Id.* at 4-5.

<sup>15</sup> *Colonial Pipeline Co.*, 116 FERC ¶ 61,078, at P 50-51 (2006).

differentials is important to maintaining shippers' relative competitive positions and, thus, to avoiding significant market repercussions. In these circumstances, the Commission cannot find the URC to be unduly discriminatory in its application.

17. Further, the amount of the surcharge will not be determined until Colonial actually files to recover the expansion costs, and in fact, as the Commission emphasized in the July 20, 2006 Order, the Commission will only authorize Colonial to collect incremental construction and operating costs above the amounts recovered by its existing transportation rates. Hunt and other shippers will have the opportunity at the time of that filing to challenge the costs that Colonial seeks to recover.

18. Finally, Hunt argues that Commission policy requires distance-based rates<sup>16</sup> and that length of haul is the primary factor in allocating costs to services and designing rates.<sup>17</sup> Hunt also cites the Commission's 1985 regulations requiring that the rates of natural gas pipelines providing open-access, non-discriminatory service "reasonably reflect any material variation in the cost of providing service due to . . . [t]he distance over which the transportation is provided."<sup>18</sup>

19. The cases and other authority cited by Hunt do not compel a different result. In deciding matters concerning oil pipelines that are regulated under the Interstate Commerce Act (ICA), although the Commission can consider policies applicable to its other jurisdictional responsibilities under the Natural Gas Act or the Federal Power Act,<sup>19</sup>

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<sup>16</sup> *Texas Eastern Transmission Corp.*, 30 FERC ¶ 61,144, at p. 61,259, *order on reh'g*, 32 FERC ¶ 61,056 (1985).

<sup>17</sup> *See, e.g., Texas Eastern Transmission Corp.*, 30 FERC ¶ 61,144, at p. 61,266 (1985). Hunt also cites *Northern Natural Gas Co.*, 14 FPC 11, 24 (1955), *aff'd* 236 F.2d 372 (8<sup>th</sup> Cir. 1956), *cert. denied*, 352 U.S. 967 (1957); *Public Service Co. of North Carolina v. FERC*, 851 F.2d 2548 (5<sup>th</sup> Cir. 1988) (upholding Commission order finding that Transco's historic zone differentials were unjust and unreasonable and requiring Transco to use the Mcf-mile method).

<sup>18</sup> Hunt cites 18 C.F.R. § 284.7(d)(3). This provision is reflected in the Commission's current regulations at 18 C.F.R. § 284.10(c)(3)(ii) (2007).

<sup>19</sup> *See, e.g., SFPP, L.P., et al.*, 86 FERC ¶ 61,022 (1999) regarding use of the KN formula to allocate indirect overhead costs; use of the South Georgia method for overfunded deferred taxes; treatment of AFUDC; treatment of purchase price adjustments; and recovery of litigation expenses.

it is not bound to do so.<sup>20</sup> Hunt's request for rehearing does not cite any precedent that would require distance-based rates, or any other particular rate design, for oil pipelines. Accordingly, as stated above, the Commission denies rehearing on this issue.

**B. Methodology for Recovery**

20. Hunt contends that the Commission must require Colonial to recover the costs of its expansion project by conforming to the rate methodologies set forth in the Commission's regulations. The Commission disagrees.

21. In the EPAct, Congress directed the Commission to establish a simplified and generally applicable ratemaking methodology for oil pipelines. In response to this Congressional mandate, the Commission established through rulemaking the simple, streamlined ratemaking methods included in its current regulations. Those methods are an index-based procedure for changing existing rates up to a rate cap level, and alternatives to index rate changes based on settlement with current shippers, lack of significant market power, or substantial divergence between costs and existing indexed rates at the cap. Colonial's expansion clearly is not an increase to existing rates, for as the Commission already has concluded, application of the URC is not a substantial change in circumstances of the grandfathered rate, and thus cannot be an increase to that rate. Current ratechanging methods therefore cannot be used to justify Colonial's proposal as Hunt suggests.

22. The Commission's regulations also provide a cost-based method for justifying an initial rate for new service. Colonial's proposal, however, is not new service but rather an expansion through capital investment. It, therefore, though based on recovery of costs, does not fall four-square into cost recovery for new service.

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<sup>20</sup> *Amoco Pipeline Co.*, 67 FERC ¶ 61,378 (1994), where the Commission at 62,296 stated:

[T]he Commission is not required to interpret the ICA in light of these other regulatory acts. While the basic jurisdictional provisions of the NGA, FPA, and FCA [Federal Communications Act] are quite similar to that of the ICA, this alone will not cause us to give deference to cases decided under those acts. Amoco fails to acknowledge that the courts have found that the FPA, NGA, and FCA differ notably from the ICA in the extent of regulatory control they establish.

23. The Commission, however, has found Colonial's project warranted and thus is loath to reject it as not within a specified rate category. The Commission has neither considered nor treated its rate methodologies as limiting its ratemaking approach or constraining it from exploring and adopting other rate approaches that are more fitting in particular circumstances to ensure that a just and reasonable rate results. The Commission has, in fact, used approaches outside its defined methodologies when circumstances have warranted.<sup>21</sup>

24. Such flexibility is in keeping with conclusions of the United States Supreme Court that "rate-making agencies are not bound to the service of any single regulatory formula; they are permitted, unless their statutory authority otherwise plainly indicates, 'to make the pragmatic adjustments which may be called for by particular circumstances.'"<sup>22</sup> The Court of Appeals also has stated:

Congress delegated ratemaking authority to FERC in broad terms. Accordingly, "the breadth and complexity of the Commission's responsibilities demand that it be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties."<sup>23</sup> In arriving at a just and reasonable rate, "no single method need be followed."<sup>24</sup>

25. Cost recovery for Colonial's proposed expansion does not fit neatly into the Commission's simplified rate methodologies, as indicated above. However, as the Commission described in the July 20, 2006 Order, the Commission found that Colonial's proposed expansion is the type of project that is appropriate to ensure reliable deliveries of competitively priced refined petroleum product to consumers. The Commission thus waived its rate methodology regulations to permit Colonial to recover its expansion costs through the URC. The Commission considers this an appropriate exercise of its ratemaking authority. The Commission has not, however, abrogated its statutory

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<sup>21</sup> See, e.g., *Express Pipeline Partnership*, 76 FERC ¶ 61,245 (1996), *reh'g denied*, 77 FERC ¶ 61,188 (1996); *Enbridge Energy Company, Inc.*, 110 FERC ¶ 61,211 (2005).

<sup>22</sup> *Permian Basin Area Rate Cases (Permian Basin)*, 390 U.S. 747, 776-77 (1968), *citing FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

<sup>23</sup> *Farmers Union Cent. Exchange, Inc. v. FERC*, 734 F.2d 1486, 1501 (D.C. Cir. 1984), *citing Permian Basin* at 790.

<sup>24</sup> *Id.* at 1501, *citing Wisconsin v. FPC*, 373 U.S. 294, 309 (1963).

responsibility to ensure just and reasonable rates. To the contrary, the Commission will review the actual URC and its application at the time Colonial files a tariff to implement the charge to recover the costs of the expansion. Affected shippers can also file challenges to the actual tariff Colonial files to implement the URC surcharge. The review process will ensure that the URC will permit cost recovery, not overrecovery, in keeping with the Commission's obligation to determine that the rate to be charged "shall be just and reasonable."<sup>25</sup>

The Commission orders:

Rehearing of the July 20, 2006 Order in this proceeding is denied, as discussed in the body of this order.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.

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<sup>25</sup> See section 1(5) of the Interstate Commerce Act, 49 App. U.S.C. § 1(5) (1988).